Extending Improvements to Tax Credits for Lower-Income Workers and Their Families

This fall, Congress will debate whether to extend tax cuts adopted over the past decade. While there appears to be general agreement among policymakers that the major middle-class tax cuts should be extended -- and significant debate about whether the tax cuts that benefit only the highest-income taxpayers ought to continue (see *MassBudget's* fact sheet Expiring Federal Tax Cuts -- Costs and Beneficiaries of Extending Cuts Targeted at Highest-Income Taxpayers) -– there has been less attention paid to the fate of tax provisions that are targeted at lower-income working families.

Recognizing that providing tax credits to lower-wage workers is among the most effective ways to stimulate the economy and create jobs,[1] Congress, in the American Recovery and Reinvestment Act (ARRA), enacted improvements to the Child Tax Credit and the Earned Income Tax Credit that particularly help these workers. It is currently unclear whether the provisions that directly help low-wage workers will be extended along with the so-called "middle-class" tax cuts.

The purpose of these tax credits is to encourage low-income earners to work by ensuring that they earn enough income to care for themselves and their children.

Over the near term, the credits will also provide a quicker, stronger boost to the economy than extending tax cuts to those in the highest tax brackets. Low-income workers generally spend all of their income -– on groceries, rent, clothing and other basic necessities, thereby bolstering the economy. Higher-income taxpayers, by contrast, are less likely to put all of the money they receive from tax cuts directly back into the economy.[2]

This *Facts at a Glance* describes these two tax credit programs and discusses how Massachusetts's working families would be affected should the improvements to these programs be allowed to expire at the end of 2010.

THE CHILD TAX CREDIT (CTC)

The Child Tax Credit (CTC) was created in 1997 to help working families care for their children. It is a partially refundable credit to low- and middle-income working families worth up to $1,000 per child under 17 years old.[3] Because it is only partially refundable, many lower-wage workers do not receive the full value of the credit.

---

[1] See "*Policies for Increasing Employment and Economic Growth in 2010 and 2011,*" Congressional Budget Office, January 2010 page 24. Available at: **http://www.cbo.gov/ftpdocs/108xx/doc10803/01-14-Employment.pdf**
[2] Ibid.
[3] Congress has made a number of changes to the credit over the years including during the Bush Administration as well as in the American Recovery and Reinvestment Act. A Congressional Research Service summary on the legislative changes to the CTC is available on the Tax Policy Center's website at: **http://www.taxpolicycenter.org/taxtopics/encyclopedia/Child-Tax-Credit.cfm**

ARRA made changes to the program for 2009 and 2010 so that more lower-income working families would be eligible for the credit, and so that more low-wage workers could receive the full credit. Under these changes, in 2010 a single mother working full-time earning the minimum wage in Massachusetts ($16,640) would qualify for a full credit for her two children of $2,000. If the changes made in ARRA are not extended in 2011, and she earns the same salary, she would qualify for a credit worth only $569, a loss of $1,431 from the value of the tax credit she received in 2010.[4]

THE EARNED INCOME TAX CREDIT

The federal Earned Income Tax Credit (EITC) was created in 1975 to encourage work by providing an offset to payroll taxes, such as Social Security.[5] The tax credit is first applied to taxes owed, then, if the taxpayer owes less in income taxes than the credit is worth, he or she receives a refund. The size of a taxpayer's credit is based on his/her earnings, marital status, and family size. The EITC begins to phase out once the taxpayer's earnings exceed a certain income that is indexed to inflation.[6]

The Recovery Act made two changes to the EITC for the years 2009 and 2010. Prior to ARRA, a family with two children received the same maximum credit as a family with three or more children. In recognition of the additional costs of caring for more than two children, ARRA expanded the maximum credit for families with three or more children from $5,036 (the same as with two children) to $5,666.[7]

Second, ARRA expanded the amount that a couple filing jointly could earn before they begin to lose their EITC benefits. Prior to corrections made to this so-called "marriage penalty," a married couple filing jointly could lose some or all of their EITC benefits. For instance Sarah, who earns the minimum wage and has two children, qualifies for the full EITC benefit. If she decides to marry Larry, who also qualifies for EITC, their combined earnings could reduce or eliminate their eligibility for EITC. If they chose to remain single, however, they would continue to receive full benefits under the program.[8] As part of its 2003 tax package, Congress allowed couples filing jointly to earn $3,000 more than single filers before their EITC benefits began to phase out. ARRA increased that amount to $5,000.[9]

Both this "marriage penalty" provision and the expansion of EITC for families with more than two children are due to expire at the end of 2010.

---

[4] Before the recent changes, lower-wage workers could receive as a refundable credit no more than 15 percent of their wages -– and they were not allowed to count a certain portion of their earnings, set at $10,000 in 2001 and indexed to inflation for each subsequent year. The Recovery Act lowers the income threshold at which wages count towards earnings for this refundable tax credit to $3,000. If the ARRA expansion is not extended, the income-threshold would be set at $12,850 in 2011, making many lower-income workers ineligible for the full credit.

[5] Holt, Steve, *The Earned Income Tax Credit at Age 30: What We Know*, Brookings, February 2006 available at: **http://www.brookings.edu/~/media/Files/rc/reports/2006/02childrenfamilies_holt/20060209_Holt.pdf**

[6] In tax year 2009 the EITC phases out for incomes as low as $13,440 (for single filers with no children) to earnings up to $48,279 (for a couple with three or more qualifying children who file jointly.) The income thresholds at which EITC phases out is available from the Internal Revenue Service at: **http://www.taxtoolkit.irs.gov/tax-topics/home-and-family/earned-income-tax-credit-eitc-and-family-credits/**

[7] Information on the maximum credit for different categories of filers is available from the Tax Policy Center at: **http://www.taxpolicycenter.org/briefing-book/key-elements/family/eitc.cfm**

[8]For an explanation of the marriage penalty see Lav, Iris, "*Extending Marriage-Penalty Relief to Working Poor and Near Poor Families*," Center on Budget and Policy Priorities, June 10, 1999, available at: **http://www.cbpp.org/cms/index.cfm?fa=view&id=1948**

[9] For instance, a single mother with two children earning $16,000 will qualify for a full credit of $5,112 in 2011. If during that year she married someone earning $25,000 then their joint earnings would be $41,000. If the change in ARRA is extended beyond 2010, they would qualify for $1,062 in credits. If the ARRA 'marriage penalty' provision is not extended they would receive only $662, a loss of $400.

WHAT WILL HAPPEN IN MASSACHUSETTS IF THESE CHANGES ARE NOT EXTENDED?

CHILD TAX CREDIT

The Recovery Act's changes expanded the number of families eligible for the child tax credit, and allowed more families to claim the full credit. Workers who benefit the most from these changes are those who work full-time and have earnings near the minimum wage.

Citizens for Tax Justice (CTJ) estimates that almost 104,000 families in Massachusetts, including almost 154,000 children, would see a $72.5 million decline in the value of their child tax credits if, as is scheduled in current law, they are prohibited from counting the first $12,850 of their wages towards this refundable tax credit in 2011.[10]

EARNED INCOME TAX CREDIT

The Recovery Act made two improvements to the Earned Income Tax Credit. The first allows families with three or more children to qualify for a larger credit than families with two children. The second reduces the 'marriage penalty' for low-income single filers who marry by increasing the total income these couples can earn before they begin to lose eligibility for the credit.

CTJ estimates that close to 87,000 Massachusetts families, including over 200,000 children, would see a $40 million decline in the value of their benefits, if as scheduled in current law, the ARRA changes to EITC are not extended. During the lame duck session it is possible that Congress will approve extension of the "marriage penalty" provision but will no longer provide the larger tax credits to families with three or more children. CTJ has estimated that in 2011 almost 60,000 families in Massachusetts will receive $20 million in benefits with the extension of the "marriage penalty" provision. If Congress chooses not to extend the larger tax credit for families with three or more children, more than 37,000 families in Massachusetts could lose approximately $20 million in credits in 2011.[11]

---

[10] See "*Refundable Credits Expanded in the Economic Recovery Act,*" Citizens for Tax Justice, Updated November 30, 2010 page 4. Available at: **http://www.ctj.org/pdf/arracredits.pdf**

[11] Ibid. pages 2 and 3.